No. 15238

United States Court of Appeals

For the Ninth Circuit

N. 2981

WESTERN MACHINERY COMPANY, a corporation,
Appellant,

vs.

NORTHWESTERN IMPROVEMENT COMPANY, a corporation,
Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON
NORTHERN DIVISION
HONORABLE JOHN C. BOWEN, *Judge*

PETITION FOR REHEARING

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PETITION FOR REHEARING

Comes now appellee and petitions this Honorable Court for a rehearing of this cause upon the following grounds:

1. The opinion of this court has confused two distinct and well-established rules of evidence. The first and principal question before the court is: What is appellee's status under the contract? The court, in considering this question, applied a rule of evidence applicable to the question: Did a signatory intend to be obligated under the terms of an initial contract? Appellee concedes it was so obligated. The parol evidence rule does not permit a party to go outside of the contract to prove that it did not intend to be obligated by the terms of an initial contract. On the other hand, an exception to the parol evidence rule does permit a signatory to prove his status under the contract. Appellee submits

that the court has failed to recognize the distinction between the two separate problems and has failed to apply the rule of evidence applicable to the real problem involved in this case.

2. The decision of this court failed to apply the Washington rule applicable to the release of a surety when the surety does not actively consent to be bound by the terms of an extension agreement made between a principal and a creditor.

The Court Has Confused Two Rules of Evidence

The appellee sincerely contends that the court's opinion of November 14, 1957, confuses two very well-established rules of evidence, and appellee believes that, in the interest of avoidance of serious error, this court on further reflection will be earnestly desirous of reconsidering its opinion in this case.

Before discussing the rules of evidence to which appellee refers, it would first be in order to briefly review a few salient facts brought out by the court's opinion. The court has before it for construction the appellant's printed form entitled "QUOTATION." It originally provided a "Quotation For Bellingham Coal Mines Company, Inc., c/o Northwestern Improvement Company," and then that name was stricken and the name of "Northwestern Improvement Co." inserted in lieu thereof. The form also provides that "This Quotation will remain in effect for ——— days from date hereof; but the prices in this *proposal* are subject to the seller's prices in effect at the time of shipment, * * * AND ARE SUBJECT TO CHANGE WITHOUT NOTICE." (Italics ours) The quotation provides for a signature

by a representative of the appellant, but does not provide a place for any other signature. On the face of the quotation without explanatory words appears the appellee's stamped name and the signature of its manager of coal operations. The court has used a letter from appellee to appellant, dated February 25, 1952, for the purpose of showing that the quotation was treated by appellee as an order. Yet, on the other hand, the court has refused to consider the effect of the statement in the letter which reads: "As you know, this equipment is being bought for the Bellingham Coal Mines Company at Bellingham, Washington, for which Northwestern Improvement Company is the operating manager, and as such has been duly authorized by the former to purchase this equipment." Furthermore, the court has refused to consider parol evidence concerning a collateral oral agreement made by the parties at the time the appellee's employee placed his signature on the face of the quotation or an earlier quotation for the same equipment made to Bellingham Coal Mines Company.

With all due respect to the court, appellee takes issue with the court's statement on page 8 of its decision that "the idea that the status of the sole signatory to a contract, as promissor, can be shown to be a surety for a third person who has not signed the instrument has no place in the law of sales. This doctrine does apply to an accommodation maker who alone signs a promissory note, and has its roots in the law merchant. Although there is dicta to the contrary, the doctrine is not applied outside this limited field, where it is now generally crystallized in a statute." After a diligent read-

ing of the Washington cases and the authorities from which the Washington court adopted its position on this problem, it is respectfully submitted that this court's statement quoted above is contrary to the Washington rule. Furthermore, neither is it supported by a decision from any other jurisdiction.

In holding that appellee could not introduce parol evidence to show that it was in fact a surety, the court failed to distinguish between two separate and distinct well-established rules of evidence. The first rule, with which appellee has no quarrel and the one upon which this court based its decision, is that an agent may not by parol evidence introduce testimony to show that, by the terms of the initial contract, it did not intend to be obligated thereby. The second rule of evidence, the one which appellee submits is involved in the instant case and the one which at all times previously has been discussed by the trial court and both litigants, is that a party to an agreement, not for the purpose of relieving itself from liability on the basis of the initial contract but for other purposes, may show by parol evidence its true status under the terms of that agreement. This court based its opinion upon the first mentioned rule of law which has no exceptions and with which appellee has absolutely no quarrel. Appellee is not in this action endeavoring to show that it ordered the machinery as an accommodation party, and thus, *ipso facto,* was relieved from liability. It is not appellee's position that it was not initially obligated in some capacity. On the other hand, the capacity under which appellee is bound under the initial agreement is the first and foremost problem before the court. In other

words, on the present record, had the appellant not taken a promissory note from Bellingham Coal Mines Company, hereinafter called Bellingham, appellee concedes it would have no defense.

Appellee believes the court was misled by the trial court's finding on failure of consideration which it criticized. That finding was not made for the purpose of proving or holding that appellee was not initially obligated. Neither appellee nor the trial court endeavored to infer or state that there was ever a failure of legal consideration under the initial order. All reference was to monetary consideration (R. 18), as distinguished from legal consideration. At the time of trial, appellant made the argument, which it later abandoned, that suretyship rules should not apply in the case of a paid surety. Consequently, appellee's proof and the trial court's finding dealt only with monetary consideration. Appellee agrees that there was legal consideration to obligate it under the contract. That, however, as the majority of courts hold, does not preclude it from setting up a defense of release of suretyship liability because of subsequent action by the appellant.

Whether appellee was initially bound is not a problem in this case, but rather the initial status under which appellee was bound is the question to be resolved. Different rules of evidence apply when those questions are presented to a court.

The above quoted statement from this court's opinion and the one case which the court's decision quotes in support of its opinion deal exclusively with the first

legal proposition—that is, whether an accommodation party could offer parol evidence to prove that it was not obligated under the initial contract. Long before trial, appellant conceded that issue and never raised it in the trial court nor in this court. The case quoted by this court, *Union Electric Co. of Missouri v. Fashion Square Building Co.,* Mo. App., 165 S.W.(2d) 284, which neither cites any authority nor has it ever before been cited, merely states the universal rule for the first mentioned legal proposition which has been distinguished by Wigmore on Evidence from the second proposition — that is, can an accommodation party prove its status—for which an entirely different rule of evidence applies. Wigmore, in discussing the circumstances under which parol evidence may be introduced to show the true status of an agent "where the unknown principal was *known* to the obligee but nevertheless not named in the document," states that the rule permits a collateral agreement to be available for the purpose of showing suretyship. 9 Wigmore on Evidence 123. This authority was cited by the Washington court in the sales case of *Zarbell v. Mantas,* 32 Wn.(2d) 920, 922, as a justification for using the rule. Wigmore, at page 124, extensively quoted from *Barbre v. Goodale*, 28 Or. 465, 38 Pac. 67, 43 Pac. 378, which Wigmore says gives the generally accepted law. At the same time, however, the Oregon court recognized and distinguished the first legal proposition—that is, that parol evidence is not admissible to discharge the agent from his obligation on the basis of the initial agreement.

The question in the *Barbre* case, *supra,* was "whether

it is competent to show by parol testimony that a contract executed by and in the name of an agent is the contract of the principal, where the principal was known to the other contracting party at the date of its execution." The Oregon court recognized that there was a split of authority, but that the generally accepted and better view was that such parol evidence was admissible to show the true status of the party signing the agreement.

With all due deference to the court's statement that a party to a sales contract "cannot prove that he signed his own name as * * * surety for another," the Washington Supreme Court, in the *Zarbell* case, *supra,* which relied upon Wigmore, in a clear and unequivocal statement held that, *in sales cases,* parol evidence and facts outside the sales agreement could be introduced to show that a signing party was in fact a surety. That case involves the sale of a car and Mantas signed ostensibly as a purchaser; yet the Washington court said:

> "At the outset, a serious point must be considered, as to whether, under the parol evidence rule, testimony tending to prove that Mantas signed the contract *in another capacity than that indicated on its face,* may be admitted. The matter is in a state of some confusion. See 32 C.J.S. 960, Evidence, §985(d), and cases there cited. The weight of authority, however, seems to be with the Oregon court, which observed, in the case of *Lovell v. Potts,* 112 Ore. 538, 207 Pac. 1006, 226 Pac. 1111:
>
> " 'When the parties to a contract know that one of the parties thereto is a surety, such fact may be shown by parol.'

"See, also, 9 Wigmore on Evidence (3d ed.) 122, §2438.

"Nevertheless, particularly in view of our own case of *Karatofski v. Hampton,* 135 Wash. 139, 237 Pac. 17, we are not prepared to state that there could not be a contract so explicit in its definition of the character of the parties signing it that parol evidence would be inadmissible to qualify it. It is not necessary to so hold here. Although both parties signed as 'purchasers,' the acquaintance blank, on the reverse side of the instrument, is filled out only with reference to the credit standing of Leaper, and is signed by Leaper alone. From this, an inference may be raised that the two parties did not in fact stand upon an equal footing as *copurchasers;* and parol evidence may be admitted to explain their true relationship, 'in order that the intention of their contract might be found and its ambiguity resolved.' *Randall v. Tradewell Stores,* 21 Wn.(2d) 742, 153 P.(2d) 286." (Emphasis supplied) *Zarbell v. Mantas,* 32 Wn.(2d) 920, 204 P.(2d) 203, 204.

The Oregon court, in *Lovell v. Potts*, 112 Or. 538, 207 Pac. 1006, 226 Pac. 1111, to which the Washington court referred, reversed and remanded the case because the lower court refused to permit in evidence a letter *antedating* the contract which would show the appellant's reason for signing the contract. The *Lovell* case, *supra,* in turn, relied upon the earlier Oregon case of *Hoffman v. Habighorst,* 38 Or. 261, 63 Pac. 610, 53 L.R.A. 908. The relationship of the parties in the case before this court is far more ambiguous and confused than in the *Zarbell* case, *supra.* Consequently, in accordance with the rule of that case, the abundance of

evidence here conclusively proving appellee to be a surety was properly admitted by the trial court.

This court also believes a different rule applies to a sales case than to a promissory note case. Such ruling was not supported by authority and is contrary to the Washington cases. The *Zarbell* case, *supra,* a sales case, relies upon the *Lovell* case, *supra,* a construction agreement case, which, in turn, relies upon the promissory note case of *Hoffman v. Habighorst, supra.* Since the Washington court clearly held in the *Zarbell* case that suretyship principles apply to sales cases, that rule must likewise be applied in this instance.

This court also states that the rule is different when there is a sole signatory. Without analyzing whether a sole signatory is significant when the first mentioned rule of evidence comes into play, the cases construing the second mentioned rule of evidence do not require such prerequisite and in fact apply the rule in cases of one signatory. When the courts use the language, "one of the parties," they have never construed that phrase to mean one of two joint parties, but have always construed it to mean any party to a contract even though there is only one party on either side of the agreement. This court's opinion did not cite any cases holding, nor does appellee believe any other courts have ever held, that, as a prerequisite to the introduction of parol evidence to establish suretyship or any other status, the principal must be a signatory to the contract. In the *Hoffman* case, *supra,* cited by the *Lovell* case, *supra,* from which the Washington court took its rule and which has been held to be the leading

case on this subject by both the Ninth Circuit and the Washington Supreme Court (page 9 of appellee's opening brief), the principal was not a signatory. Also, in sales cases involving questions other than suretyship, the courts have permitted parol evidence to show that a third party, whose name does not appear on the documents, is in fact a true party in interest. *Friend Lumber Co. Inc., v. Armstrong Building Finish Co.,* 276 Mass. 361, 177 N.E. 794, 796; *Raymond Syndicate, Inc., v. American Radio & Research Corporation,* 263 Mass. 147, 160 N.E. 821.

Appellee submits that the opinion in the instant case is the first time that any court or legal writer has ever held that one signatory is significant in the application of the parol evidence rule when proof is offered to show the status of a signatory.

This Court Did Not Apply the Washington Rule Applicable to the Release of a Surety

This court, without anlayzing pertinent cases cited by appellee in its brief, held that, even if appellee is a surety it was not discharged by reason of the extension of credit to Bellingham because Mr. McMillan "voted for" the execution of a promissory note "as a member of the Board of Directors of Bellingham" and "Northwestern was not only interested, but was pressing that a promissory note be taken, * * *."

Appellee submits that the record does not show that Mr. McMillan ever voted on the question of whether a promissory note should be given by Bellingham. Neither is there any evidence that Mr. McMillan or appellee was pressing for a promissory note from Bellingham to appellant. On the contrary, appellant asked

for the note. There is evidence to the effect that Mr. Little, Secretary of Bellingham, had board approval for the execution of the note, but there is nothing in the record from which could be inferred that Mr. McMillan, as a director, specifically gave his consent to the execution of the note. The record shows that Mr. McMillan did endeavor to obtain a forbearance, which does not amount to an extension of credit, for Bellingham on the payment of the open account, but the record is very clear that a promissory note, amounting to an extension of credit, was only discussed by the appellant with Bellingham's Secretary, Mr. Little (R. 159, 204, 237).

What is the evidence which prompted the trial court to hold "that defendant did not consent or approve, the execution by Bellingham Coal Mines Company of said promissory note" (Finding VI, R. 12) and, on the other hand, what is the record pertinent to this court's finding which conflicts with that of the trial court? On the day before the final billing for the machinery, July 30, 1952 (Ex. 4), appellant's agent, Mr. Goering, telephoned Mr. McMillan, requesting a conditional sales contract, and Mr. McMillan advised Mr. Goering that he

> "could not answer the question but * * * would refer it to Mr. Ramage, the President of Bellingham Coal Mines Company * * * and he [Mr. Goering] no doubt would hear directly from Mr. Ramage." (R. 146, 147)

Mr. McMillan's next contact with appellant was on August 10th when Mr. Goering telephoned about payment, and Mr. McMillan also told Mr. Goering that he

> "would again telephone Mr. Ramage, the President of the company, in Spokane and inform him

> of my conversation that day with * * * Mr. Goering, * * * " (R. 148)

Subsequent to the giving of the initial order, Mr. McMillan had no other conversation or correspondence with appellant concerning payment until approximately seven months following the delivery of the promissory note (R. 148). Except for the conditional sales contract, there is absolutely nothing in the record to the effect, or from which can be inferred, that any agreement which would amount to an extension of time for payment was discussed between agents of appellant and appellee (R. 159). On August 15th, Bellingham, through its President, sent a partial payment and rejected appellant's request for a conditional sales contract, and stated:

> "Mr. McMillan advises us over the phone of your request that we give a conditional bill of sale on the remaining balance. Offhand we are all very much opposed to it,* * * "

A copy of this letter went to Mr. McMillan (Ex. A-5). Immediately after appellant received Bellingham's letter rejecting the conditional sales contract, Mr. Barshell telephoned Mr. Little in Seattle requesting a promissory note from Bellingham for appellant's credit purposes. Mr. Little's testimony concerning this call was as follows:

> "Well, he called me long distance and stated in substance that the company was somewhat overextended because of all of the contracts they had outstanding, the work that they were doing, and that the bank was pressing them for payment and inquiring about this indebtedness of Bellingham Coal Mines, and I believe that at that time he

> stated to me that they would like to have a chattel mortgage or a conditional sales contract. I told him that we couldn't give any such chattel mortgage, that's my best recollection, that we couldn't [206] do it because it would constitute a preference in my opinion. He then said, 'Well, can you at least give us a promissory note which will draw interest and which we can in turn assign to the bank,' which I think was the American Trust Company, but I'm not positive, and so then that matter was taken up with Mr. Ramage and with the Board of Bellingham Coal Mines." (R. 201, 202)

Mr. Little agreed to give the note, had the note executed by Ramage in Spokane, and on August 23rd forwarded the note to appellant (Ex. A-9). The only individual contact made with Mr. McMillan about the note was Mr. Little's inquiry about the correct balance of the account. The record does not show the directors voted on the note. How board approval was obtained is not explained.

Appellant's counsel in cross-examination attempted to show that Mr. McMillan asked forbearance of payment on the open account, which Mr. McMillan acknowledged. Such request for forbearance, however, is of no significance, as the authorities agree that forbearance must be distinguished from an enforceable extension of time.

> "Mere delay, indulgence, or forbearance to the principal will not discharge the surety. In order to effect his release there must be contract for extension, binding and enforceable at law or in equity." 72 C.J.S. 652 and cases cited therein.

The only evidence or statement in appellant's briefs which could afford a basis for this court's statement that Mr. McMillan was "pressing" relate to his efforts to obtain an extension of time for payment of the note. Mr. McMillan was concerned with an extension of time on the note itself, but, as appellee pointed out in its brief (p. 25), that request came after the note was due and the extension of time had already released the appellee from liability.

The Washington court has gone further than any other court in releasing a surety from liability as a result of extension of credit. (See appellee's brief, page 26.) Whereas the majority of courts say that mere knowledge by a surety of the extension will prevent it from being released, the Washington rule requires that the surety "must actively consent to be bound by the terms of the new agreement." *Thompson v. Metropolitan Building Company,* 95 Wash. 546, 164 Pac. 222. Most certainly, appellant could not have recovered from appellee on the promissory note executed by Bellingham. The surety in the *Thompson* case was familiar with the extension agreement at the time it was made. Futhermore, although it is not mentioned by the decision, the briefs submitted to the Washington Supreme Court reveal that the surety was a stockholder of the principal at all times and was an officer of the principal at the time of the initial agreement.. In setting up this very rigid standard, the Washington court cited *Brandt, Suretyship and Guaranty* (3d ed.), Sec. 379, which states that:

> "It is not necessary that he [surety] should object thereto [an extension] in order to entitle him

to his discharge. *And even if he signs the agreement for extension as a witness, that fact will not prevent his discharge by such extension.* * * * If he is bound at all, his 'concurrence must bind him by the terms of the new (contract).' " (Emphasis supplied)

Thus, under the Washington rule, the active consent by the surety must bind the surety to the terms of the new agreement, which means that the surety must have bound himself by the terms of his "concurrence." Whatever contact Mr. McMillan had with the note, his actions most certainly did not make appellee liable on the note. The evidence here falls far short of showing "concurrence" and, therefore, under the Washington rule, does not show active consent to the extension so as to keep appellee's liability in force. Manifestly, this is so, because the record is absolutely barren of such showing.

CONCLUSION

Appellee respectfully submits that this court did not consider the correct rule of evidence applicable to the facts involved. Appellee is not endeavoring to prove that it had not intended to be obligated by the original contract, but rather is endeavoring to prove that it was bound as a surety, and thus, because of a subsequent event—the extension of credit to the principal—the appellee, as surety, was released from liability. Although the parol evidence rule will not permit a surety, agent, or any other party to show that initially he was not bound by the terms of a written contract, an exception to the parol evidence rule does permit a signatory

to show his true status under the contract. In this case, the trial court correctly applied the exception to the parol evidence rule and permitted appellee to prove that it was a surety.

Since the appellee, as surety, did not actively consent to be bound by the terms of the promissory note, which granted the principal an extension of credit, the appellee was released from liability under the terms of the original sales agreement.

Respectfully submitted,

DEAN H. EASTMAN
ROGER J. CROSBY
Attorneys for Appellee.

I, ROGER J. CROSBY, counsel for appellee herein, do hereby certify that in my judgment the foregoing petition for rehearing is well founded, and that said petition is not interposed for delay.

ROGER J. CROSBY
Counsel for Appellee.